IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 04.06.2007

Coram :

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN

AND

THE HONOURABLE MR.JUSTICE P.P.S.JANARTHANA RAJA

Tax Case (Appeal) No.202 of 2003

Commissioner of Income Tax,
Coimbatore. ..Appellant

Vs

M/s.Elgi Finance Ltd.,
Coimbatore. ..Respondent

Appeal under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras Bench-B, Madras in I.T.A. No.361(Mds)/2002 dated 12.12.2002 for the assessment year 1998-99. against ITA.No.60,61, 62, 77, 28, 78/01-02 322/1998-99 & 28/2000 on the file of the Commissioner of Income Tax (Appeals) I Coimbatore in PAN/GIR No.AAACE-4564/E dated 30.3.2001 on the file of the Additional Commissioner of Income Tax, Spl Range I, Coimbatore.

For Appellant : Mr.T.Ravi Kumar,
Standing Counsel for
Income-tax Department

For Respondent : Mr.R.Venkatraman, Sr.Counsel
for M/s.T.Ramesh Kutty

JUDGMENT
(Judgment of the Court was delivered by
P.P.S.Janarthana Raja, J.)

This appeal is filed under Section 260A of the Income Tax Act, 1961 by the Revenue, against the order of the Income Tax Appellate Tribunal, Madras Bench-B, Madras in I.T.A. No.361(Mds)/2002 dated 12.12.2002. On 01.12.2003, this Court admitted the appeal and formulated the following substantial question of law:-

"Whether in the facts and circumstances of the case, the Tribunal was right in deleting the interest accrued on "non-performing assets"?

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2. The facts leading to the above substantial question of law are as under:

The assessee is a company engaged in the business of leasing, finance and hire purchase. The relevant assessment year is 1998-99 and the corresponding accounting year ended on 31.03.1998. The assessee company filed its Return of loss for the said assessment year on 30.11.1998 admitting a loss of Rs.10,25,985/-. The Return of loss was processed under Section 143(1)(a) of the Income-tax Act ("Act" in short) on 30.03.1999 determining a total income of Rs.6,28,470/-. The assessment was revised on 10.10.2000 determining a loss of Rs.10,25,985/-. Later, the assessment was taken up for scrutiny and the Assessing Officer issued notice under Section 143(2) of the Act. The Assessing Officer noticed that in the profit and loss account for the previous year and in the memo of the total income prepared for income-tax purpose for the year ending thereof, the assessee had not admitted the interest accrued on a transaction in respect of hire purchase, leasing, bill discounting, short term loan etc. So, the Assessing Officer proposed to bring the accrued interest on those items to tax as income of the assessee relating to the assessment year. The assessee offered detailed explanation stating that treating of interest accrued on those items as income are not justified because according to the classification suggested by the Reserve Bank, those assets are to be treated as Non-Performing Assets. The assessee company being a Non-Banking Finance Company, is bound to follow the mandatory guidelines issued by the Reserve Bank of India regarding the classification of assets, recognition of income and norms for making provisions. The assessee submitted that as per the guidelines issued by the Reserve Bank of India, the income pertaining to Non-Performing Assets should not be considered as income. But the Assessing Officer did not accept the submission. The Assessing Officer found that the assessee company is following mercantile system of accounting and therefore both the income as well as the expenditure should be accounted on accrual basis. Further, the Assessing Officer was of the opinion that the guidelines issued by the Reserve Bank of India was for the purpose of financial discipline and investor production and not for any change to be brought in the method of accounting. Finally, the Assessing Officer rejected the contention and completed the assessment under Section 143(3) of the Act and determined the total income at Rs.2,78,83,950/-. Aggrieved by the order, the assessee filed an appeal to the Commissioner of Income-tax (Appeals). The C.I.T.(A) dismissed the appeal filed by the assessee and confirmed the order of the Assessing Officer. Aggrieved, the assessee filed an appeal to the Income-tax Appellate Tribunal ("Tribunal" in short). The Tribunal was of the view that the lower authorities have erred in treating the interest on Non-Performing Assets as income of the assessee company for the assessment year 1998-99 and hence directed the Assessing Officer to delete the said interest from the computation

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of the taxable income and allowed the appeal filed by the assessee. Hence the present tax case.

3. Learned Standing Counsel appearing for Revenue submitted that the assessee is following mercantile system of accounting and therefore both the income as well as the expenditure should be accounted on accrual basis. The counsel further submitted that the Assessing Officer rightly included the income as total income for the said assessment year. It is his further submission that the guidelines issued by the Reserve Bank of India is only for the purpose of financial discipline and to protect the investor and not for any change to be brought in the method of accounting.

4. Learned Senior Counsel appearing for the assessee submitted that the issue now stands covered against the Revenue by this Court's unreported judgment in the case of Commissioner of Income-tax Vs. M/s.India Equipment Leasing Ltd., Madras in T.C.(A) Nos.744 and 349 of 2004 dated 24.09.2004. Hence the order of the Tribunal is in accordance with law.

5. Heard the counsel. There is no dispute that the above issue has already been considered by this Court by the unreported judgment cited supra. Further, the Tribunal also considered the issue whether the income has in fact accrued at all or not and held as follows:-

> "In the case of Non-Performing Assets, in the light of the Notification issued by the Reserve Bank on classification of assets and the Accounting Standard-9 issued by the Institute of Chartered Accountants of India in the matter of recognising income, and also in the light of the various circulars issued by the CBDT, it is to be seen that the question of accrual can be considered only after recognising income from such assets. If no income is recognised at all from such assets, there is no question of applying the principle of accrual. The principle of accrual comes into play only when income is recognised. In the present case, the assessee has classified its assets on the basis of the Notification issued by the R.B.I. and found that certain assets are coming under the category of Non-Performing Assets. From such Non-Performing Assets, the assessee has not recognised any income in consonance with the Notification issued by the R.B.I. and AS-9 issued by the I.C.A.I. Therefore, the assessee is justified in not recognising the income as such. Once that is the case, there is no occasion to consider whether the principal of accrual

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would arise or not. In view of the matter, we are of the considered view that the lower authorities have erred in treating the interest on Non-Performing Assets as income of the assessee-company for the assessment year 1998-99. We direct the assessing officer to delete the said interest from the computation of taxable income. The interest from such N.P.As will be taxed in the appropriate assessment years on the basis of actual receipt. The issue of interest from Non-Performing Assets is therefore decided in favour of the assessee and the relevant grounds are allowed."

From the above, it is clear that the Tribunal had given a factual finding that there is no accrual of income during the year.

6. Under these circumstances, especially when the issue is covered by the unreported judgment of this Court cited supra as well as the factual finding given by the Tribunal that there is no accrual of income during the year, we are of the view that the order of the Tribunal is in confirmity with law. The learned Standing Counsel appearing for the Revenue is also unable to give any material or evidence or any compelling reason or brought to our notice any contra judgment, to take a different view. Therefore, we find no error or legal infirmity in the order of the Tribunal so as to warrant interference. Hence, we answer the question in favour of the assessee and against the Revenue. Accordingly, the tax case is dismissed. No costs.

km

Sd/
Asst.Registrar

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Sub Asst.Registrar

To

1. The Assistant Registrar,
   Income-tax Appellate Tribunal, Madras Bench-B,
   Madras.

2. The Secretary,
   Central Board of Direct Taxes,
   New Delhi.

3. The Commissioner of Income-tax (Appeals)-I,
   Coimbatore.

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4. The Additional Commissioner of Income-tax,
   Special Range-I, Coimbatore.

+ 1 cc to Mr. N. Muralikumar, Advocate, SR No.32588

+ 1 cc to Mr. R. V. Chitra & Associates SR No.31512

MBS(CO)
SR/18.6.2007 T.C.(A) No.202 of 2003

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